

**COMMENTS TO THE NOTICE OF PROPOSED RULEMAKING FCC**  
**02-285**

On October 10<sup>th</sup>, 2002, the FCC issued a Notice of Proposed Rule Making on the suitability of reforming the International Settlement Policy (ISP) and the International Simple Resale (ISR) systems based on recognising the current development of the international market of telecommunication services. All interested parties are invited to submit their comments. Another objective of this Notice is to analyse the issue of foreign mobile termination rates under the Calling Party Pays (CPP) model and how these rates might cause any prejudice to American consumers.

**Starting point**

As a starting point, and even running the risk of being repetitive, it is important to point out that substantial changes have taken place in the market since the regulation currently in force was implemented. This Notice is the result of the Commission's awareness and recognition of those changes. Therefore, and in order to ensure a perfect comprehension of the starting point, it is necessary to briefly analyse the markets that have implemented the *Receiving Party Pays* (RPP) model on one hand and the market with the *Calling Party Pays* (CPP) model on the other.

The following table shows the main market indicators in a number of advanced countries for each model:

*Sources: (1Q02): Merrill Lynch, Yankee Group, Pyramid, OVUM, IDA (Singapore's NRA)*

RPP countries	Penetration	Prepaid (%)	subscribers (000)	pop (000)	ARPU (US\$)	EBITDA (%)
USA	46%	9,74%	131 800	289 670	54	23%
Canada	34%	26,00%	11 000	32 353	28	14%
Hong Kong	83%	26,57%	5 800	6 988	28	10%
Singapore	71%	24,42%	3 000	4 225	26	34%
<b>All</b>	<b>45%</b>	<b>12%</b>	<b>151 600</b>	<b>333 237</b>	<b>51</b>	<b>22%</b>
CPP	Penetration	Prepaid (%)	subscribers (000)	pop (000)	ARPU (US\$)	EBITDA (%)
Spain	78%	65,00%	30 700	39 359	26	43,00%
Germany	69%	58,56%	55 800	80 870	22	37,00%
Italy	90%	89,00%	51 700	57 444	23	41,00%
Switzerland	75%	40,00%	5 400	7 200	44	33,00%
UK	81%	67,15%	47 700	58 889	29	28,00%
Australia	63%	26,00%	12 300	19 524	31	37,00%
<b>All</b>	<b>77%</b>	<b>67%</b>	<b>203 600</b>	<b>263 286</b>	<b>26</b>	<b>36%</b>

## Objectives of this Notice

Taking into account the current market conditions, the FCC is requesting comments on four main issues:

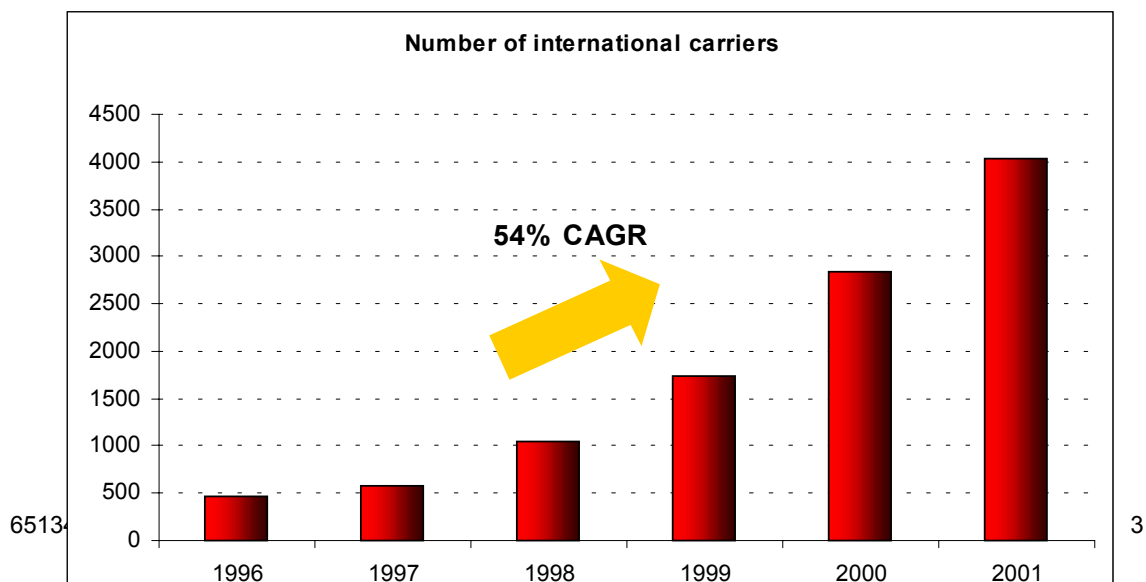
- 1) The possible reform of the International Settlement Policy and the rules for establishing accounting rates as well as the suitability of keeping the current regulation in force.
- 2) The need for undertaking initiatives to ensure the continuity of the International Simple Resale rules and to validate the existing rules.
- 3) Foreign mobile termination rates:
  - a) Whether foreign cellular operators take advantage of their dominant position to the detriment of American consumers and to the detriment of competition in the termination market for USA originated calls.
  - b) How foreign mobile termination rates affect American carriers' costs and final prices for international calls.
  - c) How to improve the information provided to American consumers.
- 4) Level of competition in foreign markets, in relation to the International Settlement Policy.

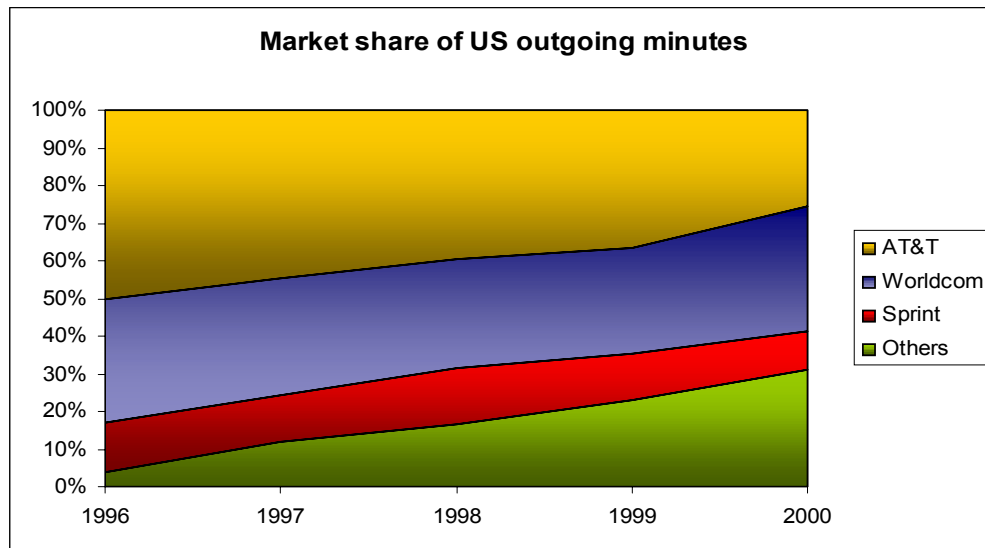
## Background analysis

After identifying the objectives of the enquiry and their origins, this section provides a brief analysis of the background.

- A. The Notice of Proposed Rule Making explains the sequence of regulatory policies regarding International Settlement Policy adopted by the Commission to improve the conditions for providing international telecommunication services to American consumers. Along that explanation, the FCC expressly recognizes the advanced development achieved by the market for international telecommunication services, both in terms of liberalisation and competition.

In fact, according to the TeleGeography 2002 report, the number of international carriers worldwide in 2001 was around 4000. Amongst the main US carriers, AT&T, Worldcom and Sprint altogether held 69% of US outbound traffic.





The following conclusions can be drawn from the previous analysis:

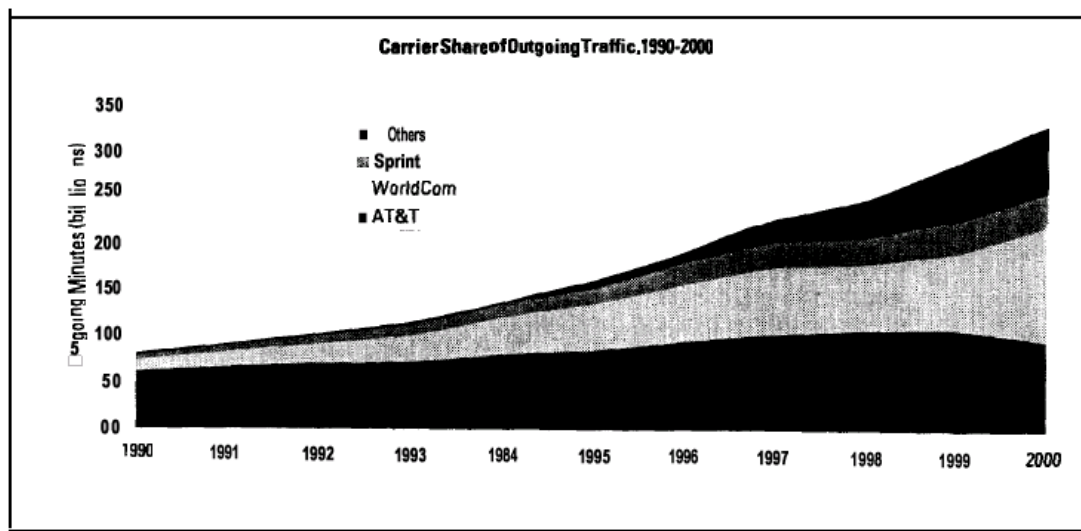
- ⇒ American regulation focuses on avoiding market distortions caused by a lack of competition. However, the market for international services has reached such levels of liberalisation and competition that make this regulation practically useless.
- ⇒ Current prices for international services demonstrate how FCC regulations have become obsolete. There is no basis for continuing the same or similar regulations.
- ⇒ This analysis shows the need for adapting regulatory measures to current market conditions. Thus, the current state of the market is the result of effective market liberalisation and the successful promotion of competition, both of which are based on internationally accepted principles of market openness and transparency. The birth and/or consolidation of new sector activities worldwide, such as the continuous growth of cellular services, cause unavoidable distortions on previously developed models. Old models become obsolete and call for a coherent revision to conform to the new environment.

- B. The FCC itself recognizes that the International Simple Resale and Benchmarks policies might be harming the further development of the market for international telecommunication services. Interestingly enough, market forces, freely configured, without regulatory intervention, have provided better solutions than the regulatory policies. Regulation has become an obstacle to the benefit of operators and consumers, completely missing its original target. This argument is the most convincing proof of the effectiveness of the market forces and should be used to answer other questions raised by the Notice. In this respect, the FCC seems to agree with the suitability of abolishing all regulation related to this matter as it suggests that such policies be eliminated and requests comments on

- C. The NPRM document provides some results apparently obtained as a result of the Commission's regulatory activity: during the period 1997 to 2001, international accounting rates have decreased from \$0.35 to \$0.14 while the average retail prices for outgoing US international calls have decreased from \$0.67 to \$0.33. Using these figures (provided by the FCC), it can be stated that the margin for international carriers (difference between average retail price and international accounting rate, not including other operational costs) has significantly increased from 48% to 58% over the same period of time. These surprising figures may lead us to consider that the benefits theoretically obtained thanks to the regulation imposed by the FCC have not been totally passed on to the US end consumer but used by the main US international carriers to significantly increase their profits.

The information provided in the TeleGeography 2002 report supports this statement: the settlement rates paid to foreign countries by the three major US carriers (AT&T, Worldcom and Sprint) have decreased from \$0.37 to \$0.19. However, the **average income per minute retained by these carriers (after paying the relevant settlement rate) has decreased by only one cent (from \$0.33 to \$0.32).**

During the same period (1997 to 2001), international US outbound traffic has increased considerably:



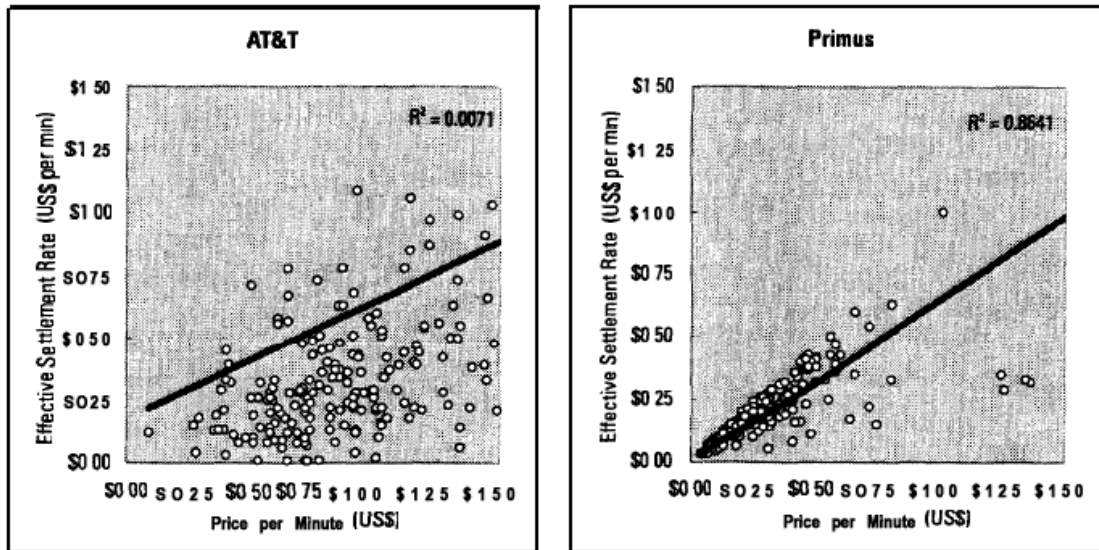
Notes: Traffic figures are for public switched network circuits based on billing point of call, not originating point. International Simple Resale (ISR) is included in facilities-based totals.

Source: TeleGeography research and FCC carrier filings

©TeleGeography, Inc 2001

Since the long-distance international market is a business involving economies of scale, under conditions of effective competition, any increase in traffic should reduce the average costs per minute that the US carrier has to bear for carrying a call from the originating point to the interconnection point through the international carrier. In addition, the costs related to capacity leasing have decreased annually by 50%. However, the

income retained by the large carriers has remained practically constant. Therefore and as the following diagrams show<sup>1</sup>, there are indications that **US carriers have not passed on these cost savings to their customers.**



Note: Each point represents the price per minute charged and settlement paid to a single country. Price per minute reflects average billed revenues per minute. Effective settlement rate reflects total settlement outpayments per minute to a country.

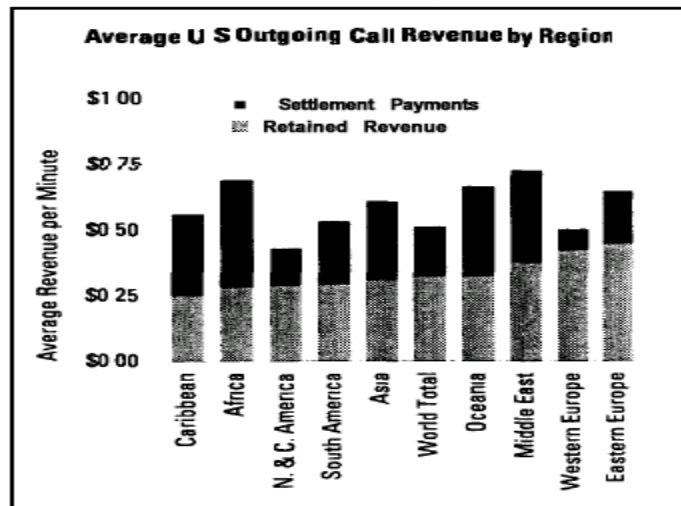
Source: FCC carrier filings and TeleGeography research

© TeleGeography, Inc. 2001

Finally, under normal market conditions, one can expect more competition for routes with greater demand. Thus, it would be logical to assume that the part of a call retained by a US carrier (after paying the international settlement rate) would be lower in the case of calls to Western Europe (main destination of the US outbound traffic) than to Africa. This may be explained by the fact that the important flow of outbound traffic to Europe would justify the deployment of dedicated lines, while traffic destined for Africa

<sup>1</sup> From the analysis of these diagrams the TeleGeography 2002 report concludes: "We've already seen that termination costs affect the prices international carriers charge for their services. Calls to fixed line telephones are relatively cheap; calls to mobile phones are relatively expensive. Yet just how closely interconnect costs correlate to prices depends on the carrier. Carriers, such as Primus, that operate largely as carriers for the traffic of other telecom service providers must offer rates closely co-related with actual. Because the customers of these wholesale carriers are themselves telcos with a high degree of market knowledge, wholesale carriers must continually adjust their rates to match market realities. In contrast, incumbent telcos such as AT&T carry a much larger proportion of retail traffic from individual homes and businesses. Such customers are far less sensitive to fluctuations in the international call charges to specific routes than are the customers of wholesale carriers. Customer loyalty stems from factors other than price. Retail carriers also incur different costs (for example, marketing) than wholesale carriers, which focus primarily on interconnect charges. As a result, international prices offered by retail-oriented carriers do not correlate well with the interconnect charges they must pay."

would be carried through a reseller at higher costs. However, according to TeleGeography 2002, US carriers' retention per minute is higher for calls to Western Europe than for calls to Africa. This might indicate that international carriers in the US might be abusing their market dominance since they are setting retail prices higher than the efficiency level, thus trying to take advantage of the large amount of traffic to Western European countries:



## **Comments on issues related to mobile termination rates in countries with CPP system**

*Comments on the differences between the Receiving Party Pays (RPP) and Calling Party Pays (CPP) models.*

While each geographical area or country has freely chosen the model to be applied, this choice has significantly influenced the development of national telecommunication markets. Thus economic data clearly indicate that those countries which have opted for the CPP model have achieved major benefits for their societies, more quickly over time and basing themselves on the development of mobile telephony.

Likewise, there is a direct relationship between the entry barriers to mobile services and the model adopted for each country. Due to its features, the RPP model causes greater difficulty for low consumption segments or segments with low income levels to access mobile telephone services, since they cannot directly control their telecommunication costs as the latter also depend on incoming calls that the user does not make. Therefore, the entry barriers to the mobile market are high in those countries which have opted for the RPP model. However, the CPP model has permitted this market to be open to all users and has also permitted a successful implementation of the prepayment method, thus increasing the level of penetration of mobile telephony, accessible to all citizens.



The Notice itself explains the current situation involving foreign mobile termination rates as a result of the differences that exist between the RPP and CPP models. With the RPP model, terminating a call on a mobile network is remunerated by the receiving party, e.g. the destination mobile subscriber, based on the corresponding airtime prices. However, with the CPP plan, terminating a call on a mobile network is remunerated by the so-called "interconnection tariff", which is paid by the network operator originating the call to the destination network operator (this "interconnection tariff" is hereafter referred to as the "termination tariff"). This termination tariff is fully justified by the business model of the mobile operator that supports the CPP model, which is generally a result of the regulatory model adopted in the country of operation as well as its characteristics designed and imposed by the competent national regulatory authorities.

This distinction between models also affects the nature of the call termination service itself: while with the RPP model, call termination is conceived as a service offered by the destination operator to the final user receiving the call, with the CPP model, call termination is a service offered by the destination operator to the operator originating the call. Thus, with the CPP system, the relationship is limited to the network operators, preventing the consequences of this relationship from being extended to the service provision conditions offered to the end user.

The disparities between the two models account for the differences in the mobile termination tariffs. CPP mobile termination tariffs are higher than RPP mobile termination tariffs. Nevertheless, the fact that these mobile termination tariffs are higher does not mean in any way that they are not fully justified. The basic principle of cost orientation, which exists with practically all national regulatory systems, guarantees tariff justification.

As a matter of fact, CPP mobile terminations tariffs are generally subject to the cost orientation principle. For instance, in Europe, interconnection tariffs for operators designated as having Significant Market Power in the interconnection market must comply with this principle of cost orientation. Furthermore, the termination tariff control is not only limited to operators with Significant Market Power, but, in most countries, also applies to other operators in these markets, either through the application of this principle to all existing operators (whether they have Significant Market Power or not), as in the case of the United Kingdom, Portugal and The Netherlands, or by imposing on operators not stated as having Significant Market Power the obligation to observe some alignment with the cost-oriented prices of operators that have Significant Market Power in such a way that the difference does not exceed an established percentage, as it occurs in Belgium or Sweden. Even in Spain, the NRA has recently decided to enforce the lowering of termination tariffs for operators without Significant Market Power, for the sake of correcting market distortions that have occurred due to the appreciable difference between the tariffs charged for the latter and those which, through regulatory requirement, should apply to those operators with Significant Market Power.

In some other countries such as Brazil or Chile, mobile termination tariffs are directly decided by the National Regulatory Authority. Mobile operators are not able to alter or modify them.



such measures imposed to the problem detected. All this guarantees that a real and effective control on mobile termination tariffs exists in all European Union countries and mostly in all CPP markets. Moreover, in some cases, mobile termination tariffs are directly imposed by the NRAs. Both controls limit the mobile operators decision-making abilities. Precluding the independence of mobile operators behaviour is the basic premise for the existence of abuses of dominant positions. Any abuse would then be subject to an ex-post control of the NRAs, in accordance with the sectoral regulation and Competition Law (and, in the case of the European Union, by the European Commission as well). This would result in its immediate correction so that the mobile operator causing the abuse would be required to cease the action. The acceptance of the existence of mobile termination tariffs that do not comply with these regulatory obligations calls into question the NRAs' competence and would mean that these authorities acknowledge behaviour prejudicial to national customers and not only to international ones.

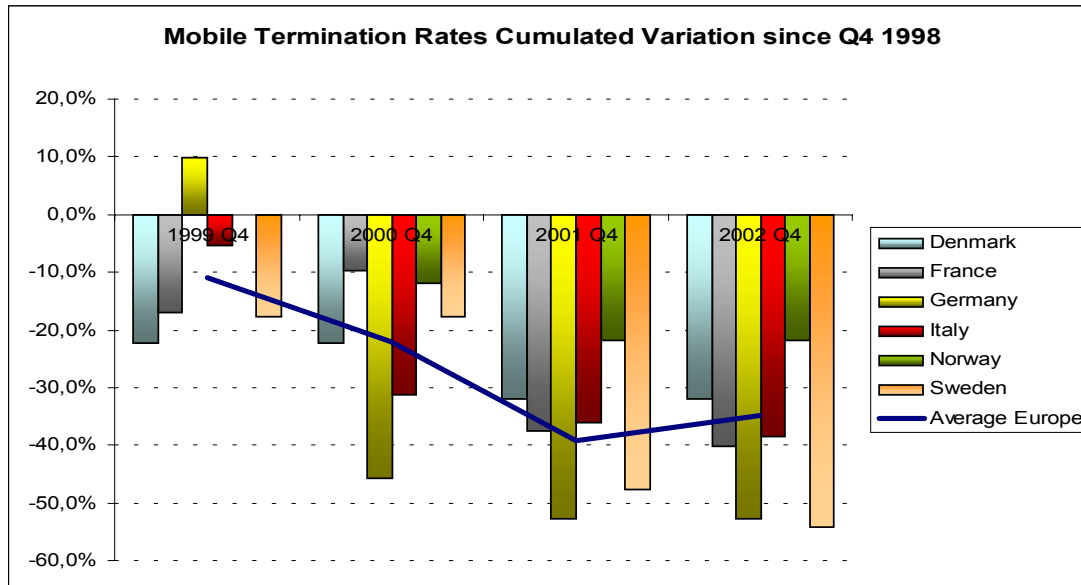
## *Comments on the level of competition in markets with the CPP model*

There is no doubt that the spectacular development of the telecommunications market which occurred over the last decade has been based on a reliance of market forces. Consequently, wherever the fair play of market forces is guaranteed, imposed regulatory measures are not desirable.

In the case of calls with a US origin and destination on foreign mobile networks, suitable price definition for this termination service implies the efficient functioning of both the international services market and the mobile termination market.

The FCC itself comes to recognise that the level of competition in the market of international services has been tremendous over the past few years. The liberalisation process in the telecom sector, the deployment of a substantial number of high-capacity international networks and the development of technical procedures allowing price arbitration in this market are some of the aspects that have contributed to this leverage of the degree of competition. Today, US international carriers are able to effectively choose among multiple alternatives for terminating their international traffic.

At the same time, evidence shows the proper operation of the mobile termination markets. Taking into consideration the European scene —since it is the region where the CPP model is more developed— there is practical evidence for considering that market dynamics have led to decreases in mobile termination prices based on mobile operators translating efficiencies resulting from market development to their own prices.



Additionally, as previously stated, NRAs' supervision capabilities in each country guarantees the efficient operation of this market. Termination in mobile networks is subject to strict regulatory vigilance. Thus, it is not realistic to think that such a market failure occurs without a subsequent reaction by these Authorities. These control capabilities are even more strict in some regions, such as Europe, where supranational regulatory Authorities do exist. Based on this, additional pressure – either direct or indirect - by the FCC on these markets could not be easily justified.

The FCC should take into consideration the fact that price decreases in the prices that US international carriers pay for terminating calls on an international fixed-line network have been possible, to a great extent, due to this NRA activity. The liberalisation process of these markets, supervised by these independent bodies, has led to important decreases in termination prices. These price decreases have been directly and immediately passed on to national consumers and also to the terms of the international settlement agreements between international carriers in order to be further passed on to US consumers as well.

*There is no discrimination against US consumers.*

The acceptance and application of the non-discrimination principle is compulsory for operators in a State where GATS commitments have been adopted. These commitments and, once again, their supervision by the NRAs, prevent the existence of different prices for termination services depending on the interconnected operator or the origin of the call.

Thus, the price that carriers transporting international calls must pay, no matter what the origin of the call, is exactly the same as for other operators, either national or international. This model is a result of the application of non-discrimination obligations. From this perspective, it is not possible to imagine a differentiated price for terminating calls that have a US origin.

In the same way, still on the basis of the non-discrimination principle, a positive

consumers cannot be contemplated either. This hypothetical case could lead or facilitate practices involving the so-called "refilling" phenomenon, routing the traffic destined to non-US mobile operators through US international carriers benefiting from these special advantages.

## *Comments on proposals for providing better information to US consumers on foreign mobile termination tariffs*

Before going into these comments, it must be stated that the alleged lack of awareness by US consumers on mobile termination tariffs is surprising considering the current environment for mobile telephony. As a matter of fact, given the context of development of the cellular market, with an already important subscriber base, an increasing volume of mobile traffic and a percentage of international calls destined for foreign mobile networks amounting to 21% —as stated by the FCC itself in the text of the Notice—, it is surprising that such a general lack of awareness exists.

At any rate, if this lack of awareness really does exist and US consumers are not aware of the existence of surcharges and prices to be paid to international carriers for calling foreign mobile networks, there is an urgent need for the US operators to provide one or several of the procedures available on the market for this purpose, as they have undoubtedly already done with regard to the information about call charges for international calls destined for foreign fixed-line networks.

There are numerous procedures most commonly used to communicate to or inform consumers about tariffs. One of the most effective ones, allowing a continuous updating of tariffs, involves the use of a recorded information message prior to any international call. Other possibilities involve delivering brochures with the tariff structure at the time the service is subscribed to or when new services are launched or when any changes are to be implemented, or by advertising these tariffs using various media: Customer Relationship Centres, operators' web pages, etc.

## **Comments on the suitability of the procedure initiated with the NPRM**

Taking into consideration the existence of the GATS within the WTO, before undertaking any unilateral action, the FCC must seek the best possible solution of conflicts within the WTO-GATS. Since the USA is a Member State of the WTO, this must be the preferred procedure for undertaking the resolution of any conflict relating to the services industry amongst its members.

Furthermore, conscious of the fact that one of the objectives that inspired the negotiation of the AGCS, of which the USA was a clear proponent, was the "establishment of a multilateral framework for principles and laws directed at the progressive opening of the services industry to facilitate the expansion of this trade and contribute to the economic development of the entire world".

Government of the USA should comply with this multilateral framework for negotiating and resolving its interests. It should furthermore recognise that the commercial practices currently in effect are contributing to world economic growth (thus complying with economic policies and the free market of each Member State in its entirety). In short, its decision should not be solely based on the cost savings for its own consumers, the reduction of costs for North American carriers and an equilibrium in the USA's balance of payments.

Even though other countries are complying with the rules set by the WTO, if the FCC considers that there could be indications that international carriers and some foreign mobile operators are abusing their dominant position by setting termination tariffs, to the extent that it affects outbound USA international traffic (service industry), it should propose those reforms that it considers necessary regarding its operating rules within the forum of the WTO.

Another reason for the North American government to present its proposals at the WTO is found in Section V of the AGCS. Article XXIII stipulates that in the event a Member state considers that another State is not complying with its obligations or specific commitments contracted by virtue of this agreement, it may have recourse to the Protocol procedure regarding the Resolution of Differences.